

NY Federal Court Refuses to Consider Extrinsic Evidence of an Insurer's Claim Handling for a Different Policyholder

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In *Spandex House v. Hartford Fire Insurance Company*, an insurer prevailed in a breach of contract and declaratory judgment action arising from an underlying suit against its insured, Spandex House Inc.[1] In the underlying case, the plaintiff, Rex Fabrics, alleged that Spandex House had infringed on its copyrights by manufacturing identical garments, as well as through its marketing and advertising activities. The court held that an unambiguous IP Exclusion barred coverage and that a narrow Advertising Exception to the exclusion did not apply.

Spandex House sought coverage under the policy's Personal and Advertising Injury Liability coverage. However, Hartford denied coverage based on the policy's IP Exclusion which precludes coverage for personal and advertising injury 1) "arising out of" allegations of infringement of intellectual-property rights and 2) any damages alleged in "any claim or 'suit' that also alleges" infringement of intellectual property rights. The court held that this exclusion was unambiguous on its face, ruling in favor of Hartford. In doing so, it refused to consider extrinsic evidence offered by Spandex House that Hartford had agreed to provide a defense to a different policyholder under similar circumstances. The court reiterated longstanding New York law that extrinsic evidence may not be used to create an ambiguity in a written agreement that is unambiguous on its face.

Next, the court considered whether Spandex House's claim fell within an Advertising Exception to the IP Exclusion. The Advertising Exception states that the IP Exclusion does not apply "if the only allegation in the claim or 'suit' involving any intellectual property right is limited to: 1) [i]nfringement, in your 'advertisement,'" of copyright, slogan, or title, or "2) [c]opying, in your 'advertisement,' a person's or organization's 'advertising idea' or style of 'advertisement.'" The court again found the language of the policy to be unambiguous: "when a lawsuit is excluded from coverage pursuant to the IP Exclusion, the Advertising Exception will apply if 'the only allegation' in the lawsuit is an act of infringement or copying that is causally related to the insured's advertisements." The court found that because the underlying lawsuit clearly involved allegations that were not causally related to the insured's advertisement – namely that Spandex House had copied the designs of several garments – the exception did not apply.

The court dismissed Spandex Houses' arguments that regardless of the wording of the policy, the policy should provide coverage because the IP Exclusion and Advertising Exception violate longstanding principles of insurance law.

In the first of its equity-based arguments, Spandex House argued that the policy violates the "entire action rule." Under New York law, if a lawsuit contains a mix of allegations covered by an insurance policy and other allegations falling outside the scope of the policy, the insurer is required to defend the policyholder against the entire lawsuit. Spandex House argued that by providing coverage only when the sole allegation against the insured was related to the insured's advertisements, Hartford's policy was seeking to circumvent the entire action rule. Spandex House contended that as long as any of the allegations related to an insured's advertisement, the policy should provide coverage. The court found that, "[i]n some sense, Spandex House is correct" that the policy circumvents the entire action rule. However, it found that the policy was not technically in violation of the rule because, unless the sole allegation against the insured was related to the insured's advertisements, there would be no covered claim under the express language of the policy.

Therefore, the claim against the insured did not involve a mix of covered and uncovered claims. More importantly, the court recognized that its job is to enforce the policy language as written and that it is not free to substitute notions of fairness and propriety instead of the express provisions of the parties' agreement.

Additionally, Spandex House argued that Hartford and the court must look to facts outside of the underlying complaint when determining the duty to defend and that an insured's right to a defense should not depend solely on the allegations that a third party chooses to put in the complaint. While the court agreed that this was a correct statement of law, it found that there were simply no extrinsic facts that would show that the only allegation against Spandex House involved its advertisements. Quite to the contrary, the record was clear that the allegations against Spandex House involved the sale and distribution of allegedly copyrighted materials.

Spandex House represents a win for insurers as well as the general principle that insurance contracts should be enforced as written. Despite multiple invitations to do so, the court refused to look past the plain language of the policy in favor of its own views on equity.

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[1] 2019 U.S. Dist. LEXIS 144646 (S.D.N.Y. Aug. 26, 2019).

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